المركز المصرى للدراسات الاقتصادية
ECES
The Egyptian Center for Economic Studies

MONETARY POLICY IN EMERGING MARKET COUNTRIES WITH IMPLICATIONS FOR EGYPT

JOHN B. TAYLOR

DISTINGUISHED LECTURE SERIES 23

A PUBLICATION OF
THE EGYPTIAN CENTER FOR ECONOMIC STUDIES

Contents

FOREWORD

The presentation by Dr. John Taylor at ECES on April 5, 2005 could not have come at a better time. Monetary policy in Egypt was and continues to be in a state of transition. Having adopted a flexible exchange rate regime in January 2003, there has been keen interest in learning how other countries made the transition from anchoring monetary policy around the exchange rate to price stability. In particular, what monetary policy rule did they follow, and what were the results of following such a rule? The presentation also came at a time when Egypt was witnessing a heated debate over the merits of raising interest rate to curb inflation despite the possible negative repercussions on investment and economic growth in the short run.

In this *distinguished lecture*, Dr. Taylor provides lucid answers to many of these questions and more. Besides the speech, the publication includes a summary of the subsequent question and answer session. In the summary, the reader will find very informative responses from the speaker to such queries as the appropriate measure of inflation, central bank independence, fiscal dominance, and the trade-off between inflation and unemployment. I am confident that both the paper and the discussion will be enormously useful for informing discussions on monetary policy issues in Egypt for years to come.

Ahmed Galal
Executive Director and Director of Research, ECES
May, 2005

تقديم

تأتي محاضرة د. جون تيلور المتميزة في وقت تشهد فيه السياسة النقدية في مصر تحولات كبيرة في أعقاب تحرير سعر الصرف في يناير ٢٠٠٣. وقد أدت هذه التحولات إلى تزايد الاهتمام بخبرات الدول التي نجحت في اتباع سياسة نقدية تستخدم معدل التضخم بدلا من سعر الصرف كمحور ارتكاز اسمي، وخاصة طبيعة القاعدة النقدية التي طبقتها هذه الدول، والنتائج التي ترتبت عليها. كما تكتسب هذه المحاضرة أهمية خاصة نظرا للجدل الدائر في مصر حول مزايا رفع سعر الفائدة في الحد من التضخم على الرغم من العواقب السلبية التي يتصورها البعض على كل من الاستثمار والنمو الاقتصادي.

وفي هذا العدد من سلسلة المحاضرات المتميزة، يقدم د. تيلور عرضا وافيا حول هذه القضايا، كما يجيب عن العديد من التساؤلات التي أثارها الحضور عقب العرض ومنها العلاقة بين التضخم والبطالة، واستقلال البنك المركزي، وتحديد معدل التضخم المناسب. وليس لدي شك في أن القارئ سيجد في هذا العرض والمناقشات الكثير من الأفكار المفيدة في مجال إدارة السياسة النقدية في مصر خلال المرحلة القادمة من الإصلاح الاقتصادي.

د. أحمد جلال

المدير التنفيذي ومدير البحوث

المركز المصري للدراسات الاقتصادية

مايو ٢٠٠٥

ABOUT THE SPEAKER

John B. Taylor

Under Secretary for International Affairs
U.S. Department of the Treasury

John B. Taylor is currently the Under Secretary for International Affairs, U.S. Department of the Treasury. He is currently on leave from Stanford University, where he is the Roberts Professor of Economics. Taylor is a globally recognized expert on international monetary and financial issues and has produced extensive research on monetary policy, fiscal policy, and international economic policy.

Before joining the Stanford faculty in 1984, he held positions as professor of economics at Princeton University and Columbia University. Taylor has also served as Senior Fellow at the Hoover Institution; Director of the Stanford Institute for Economic Policy Research; Director of the Stanford Introductory Economics Center; and Research Associate at the National Bureau of Economic Research.

Taylor's previous government experience includes serving as senior economist on the Council of Economic Advisers; member of the Council of Economic Advisers; and member of the California Governor's Council of Economic Advisers. Taylor also served as a member of the Congressional Budget Office's Panel of Economic Advisers and was a delegate to the Uruguay Round of trade negotiations. He earned his Ph.D. in Economics from Stanford University.

PART I

MONETARY POLICY IN EMERGING MARKET COUNTRIES WITH IMPLICATIONS FOR EGYPT

Thank you for inviting me to speak today about monetary policy in emerging market countries and the implications for Egypt. One of the most rewarding parts of my job as U.S. Treasury Under Secretary has been working with officials in emerging market countries on the formulation and implementation of monetary policy. I particularly welcome the opportunity to speak in Egypt today,[1] because Egypt is not only making noteworthy changes on economic reforms in reducing tariffs and taxes, but also on monetary policy operations.

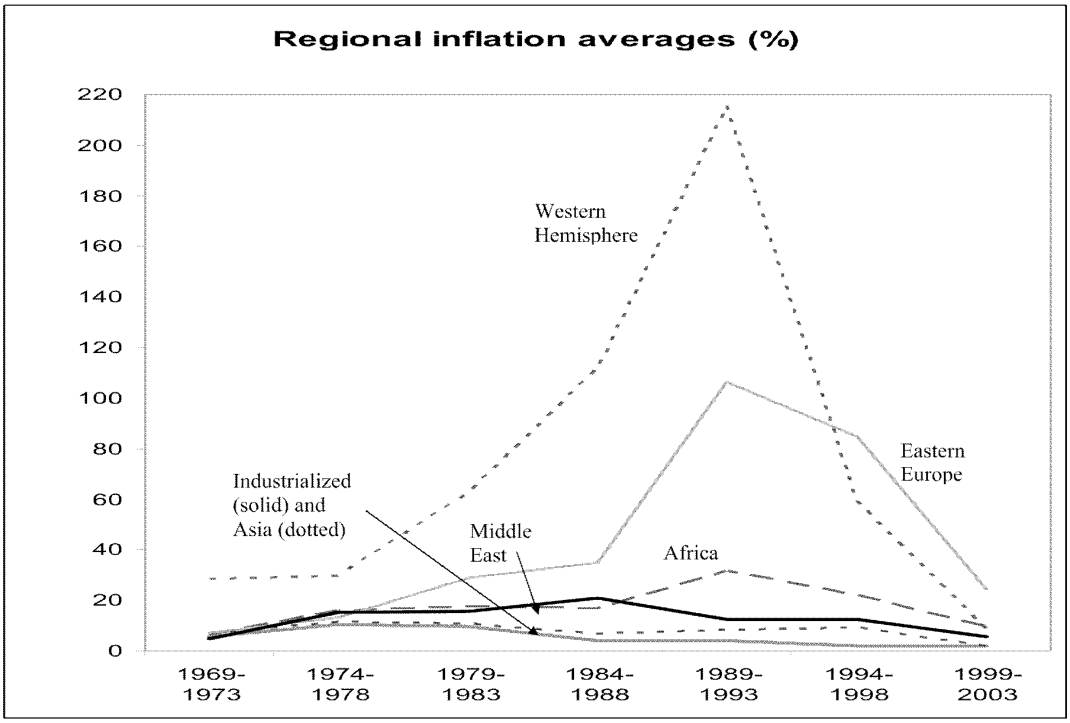
In recent years, a number of other countries have adopted monetary policies similar to those which Egypt is heading toward, and their experience is very encouraging. First, inflation has come down significantly. Instead of spiraling upwards, nearly out of control, prices have become much more stable. We can call this the new era of price stability. Second, recessions have become less frequent and milder and economic expansions have gotten longer. In other words, the new era of price stability has been accompanied by a new era of overall economic growth and stability.

I began studying the connection between price stability and economic stability back when I was a professor in the mid-1990s and I concluded that this connection is causal, not accidental. Why? Simply put, the improvement in price stability has virtually flattened the boom-bust cycles in which inflationary booms inevitably were followed by recessionary busts. In any case, by studying the experiences in other countries, I believe one can find important implications for Egypt.

[1] This speech was given at a distinguished lecture held at the Egyptian Center for Economic Studies on April 5, 2005.

IMPROVEMENTS IN PRICE STABILITY

The figure below shows this reduction in inflation, or, in other words, the increase in price stability. Starting about 20 years ago, and then gaining momentum, the rate of inflation has fallen in every region of the world. This contrasts with the much higher inflation around the world from the late 1960s through the 1970s. The reduction in inflation in the United States in the late 1970s and early 1980s was one of the first successful attempts to move toward price stability and it ushered in a period of price stability that has been the subject of an enormous amount of research.



Source: International Monetary Fund. 2004. *International Financial Statistics* database, March.

But while the movement toward price stability may have begun in the United States, it is clearly not confined to the United States, as the figure shows. Inflation has declined for every

region. Moreover, if you look at data for individual countries within the regions, you see the same phenomena. For example, looking at the data for countries in the Middle East, we see trends toward price stability in many countries in recent years. In 1990, six of the 12 countries in the Middle East, for which data are available, had inflation rates in double digits; and now, according to the most recent data, only three of 16 countries have inflation in double digits.[2]

What brought about this reduction in inflation? I believe it can be traced to two factors. First, central banks began to focus more seriously on the goal of price stability, or low inflation. Second, and equally important, they developed more effective and systematic procedures for changing the instruments of monetary policy to bring about the goal of price stability. Consider each of these factors in more detail.

Price Stability Goals

The increased emphasis on price stability first began in the late 1970s and early 1980s and now commands worldwide respect. This emphasis followed from the growing consensus that no long-run trade-off exists between inflation and unemployment or economic growth. In the 1960s and 1970s, economists thought a trade-off existed. The more recent view is that inflation is harmful to economic growth. It creates volatility, raises real interest rates, and reduces private investment. Inflation also hurts the poor, who are least able to hedge.

I best recall the change in focus in the United States. The intellectual forces included Milton Friedman's work on the inflation-unemployment trade-off and the new *rational expectations* school of monetary policy, which lowered the estimated costs of reducing inflation. The practical implementation was, of course, the job of the Federal Reserve and under Paul Volker's leadership policies were put in place to bring inflation down by radically changing how the

---

[2] Inflation data for the Middle East: Countries included Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syria, Turkey, United Arab Emirates and Yemen. For 1990: Double-digit inflation in Egypt, Israel, Jordan, Lebanon, Syria and Turkey. Data are from IFS; no data for Iraq, Oman, Yemen and United Arab Emirates. For 2003: Double-digit inflation in Iran, Iraq and Yemen. Data are from IFS, central bank websites, and the CIA World Factbook.

instruments of policy responded to inflation. Since then, under Alan Greenspan's leadership, price stability has remained the goal. While not setting a specific numerical definition of price stability, Chairman Greenspan's statements that price stability occurs at a level of inflation that does not distort decisions suggest an inflation level of around two percent. Indeed, two percent was the target inflation rate I suggested as a benchmark in designing the Taylor rule.

As the importance of the goal of price stability spread around the world, a number of countries found setting a numerical target, or target ranges, to be useful. For example, in the early 1990s Chile and New Zealand adopted specific numerical targets for inflation. In New Zealand, they even used the target as part of an official performance agreement between the governor of the central bank and the minister of finance. The Bank of England adopted numerical inflation targets in the mid-1990s. Since then, a number of other central banks—Canada, Brazil, Turkey, for example—have found it useful to set numerical targets for inflation. Except for transition periods, the target for inflation in all cases is very low, and not too far from the two percent benchmark.

There has been some debate about whether setting a formal numerical target for inflation is beneficial. Clearly, it is possible to achieve the goal of low inflation without setting a numerical target, as the Federal Reserve has shown, so the answer depends on circumstances in each country. Whether a numerical target is used or not, it is essential that the central bank takes the goal seriously and that it is understood to be a very low rate of inflation. It is easy to say that the goal is price stability, or to post such a goal on a central bank web page, but it is much different to actually make the decisions that will bring it about.

Systematic, Transparent Procedures for Setting Policy Instruments

A second important change in monetary policy is in the way central banks set their instruments of policy as they endeavor to achieve the goal of price stability. There are two main choices for the instrument of monetary policy: the interest rate, or a monetary aggregate such as the monetary base. Either type of instrument can be used to achieve an inflation target, but in recent years there has been an increased focus on the interest rate.

Increased focus on the interest rate has encouraged policy makers and economists to think more *systematically and transparently* about central bank decisions. They need to consider whether the change in the interest rate instrument is large enough or too large. For example, they need to decide how much to raise interest rates when inflation picks up, and they need to know whether lowering interest rates during a recession is consistent with the goal of price stability. Furthermore, each adjustment decision and the policy instrument should not be viewed as an isolated one-time adjustment, but rather as part of a multi-period strategy taking expectations and their long-term effects into account. This is where the use of policy rules can be helpful.

The Taylor rule, for example, sets out certain principles that help policy makers determine whether the instruments are changed in a way that will achieve price stability. For example, it calls for increasing the interest rate instrument *by more* than an increase in inflation. This principle, which is imbedded in the Taylor rule, aims at increasing the *real* interest rate in the face of an increase in inflation. The Taylor rule also calls for lowering interest rates when there is a recession. The use of such a policy rule also emphasizes the importance of transparency and clear communications because it implies that these same principles will be applied in future decisions.

Experience has shown that central banks that have been successful in lowering inflation have followed these principles, and those that have not been successful in achieving price stability have not followed these principles. For example, during the late 1960s and 1970s when the Fed was unsuccessful in achieving price stability, interest rates did not rise by more than the increases in the rate of inflation.

As part of the effort to be more systematic and transparent, central banks now reveal much more information about how they arrive at their policies and what effects those policies have. They now release information about monetary policy meetings more quickly, and communicate to the public through speeches and press releases more than ever before. Effective central banks use these channels of information to inform the public of their strategy for monetary policy. It is

especially useful for the public to know that the central bank remains committed to a long-term strategy for achieving price stability in the face of temporary ups and downs in inflation.

An important aspect of a transparent monetary policy is a unified exchange rate. A unified rate sends the clearest market signal and is far more likely than dual or multiple rates to be free of corruption and other distorting influences. In 2001, Egypt established a unified official rate. More recently, it eliminated differences between the official rate and the unofficial parallel rate. These are praiseworthy steps.

THE EXCHANGE RATE QUESTION

When capital markets are open internationally the interest rate decisions described above have obvious implications for the exchange rate and exchange rate policy. There are two viable approaches to exchange rate policy. One is to adopt a flexible exchange rate so that the central bank is free to make the interest rate decisions needed for price stability according to the policy principles discussed above. The other choice, more relevant to small countries, is to join a currency union or adopt the currency of another central bank that follows good policy principles. An intermediate case is to adopt a pegged exchange rate, which does not create a permanent tie to another currency. But the lack of permanence has led to credibility problems and the frequent collapse of such pegs. The Bretton Woods system was based on such pegs and it indeed collapsed.

More recently, there has been movement away from such intermediate exchange rate arrangements and many countries now have flexible exchange rates. Among them are the United States, the United Kingdom, the Euro Zone, as well as large emerging market economies such as Brazil and South Africa. The movement away from intermediate exchange rate arrangements is also visible to some extent in the Middle East. Egypt, Yemen and Turkey have flexible exchange rates. Alternatively, some other countries have dollarized, adopting a foreign currency as their official national currency. By the IMF's count, 46 countries had flexible exchange rates at the

end of 2003. There are also 50 countries and 30 or more territories that have monetary unions, dollarization, currency boards, or currency board-like systems.[3]

SOME IMPLICATIONS FOR MONETARY POLICY IN EGYPT

Having considered the principles of price stability and exchange rate regimes, how could these lessons be applied to Egypt? In 2004, inflation in consumer prices was 11.3 percent in Egypt. The rise in inflation from the low single digits that prevailed for several years is related to two factors. One factor is the gradual passing through of higher prices resulting from the depreciation of the Egyptian pound in 2003. The other factor is the revision of the consumer price index in

---

[3] ***Exchange rate regimes***
(* = not independent)
Flexible exchange rates: The IMF lists the following countries as having independent floats at the end of 2003: Albania, Armenia, Australia, Brazil, Canada, Chile, Colombia, Congo (Democratic Republic), Guatemala, Iceland, Japan, Korea (South), Liberia, Madagascar, Malawi, Mexico, New Zealand, Norway, Papua New Guinea, Philippines, Poland, Somalia, South Africa, Sierra Leone, Sri Lanka, Sweden, Switzerland, Tanzania, Turkey, Uganda, Uruguay, United Kingdom, United States and Yemen. To these should be added the members of the European Central Bank regarding their external exchange rate: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. (These data come from the IMF's 2004 *Annual Report on Exchange Arrangements and Exchange Restrictions* and are for the end of 2003. The list comprises what the IMF terms independent floats. The IMF classified Egypt as a managed float).
Monetary unions:
Eastern Caribbean Currency Union: *Anguilla, Antigua and Barbuda, Dominica, Grenada, *Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines
CFA franc zone—BEAC: Cameroon, Central African Republic, Chad, Congo (Republic), Equatorial Guinea, Gabon.
CFA franc zone—BCEAO: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.
CFP franc zone: *French Polynesia, *New Caledonia, *Wallis and Futuna.
European Central Bank: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain.
Dollarization: *American Samoa, Andorra, * British Indian Ocean Territory, *British Virgin Islands, *Christmas Island, *Cocos (Keeling) Islands, *Cook Islands, East Timor, Ecuador, El Salvador, *Greenland, *Guam, Kiribati, *Kosovo, Liechtenstein, Marshall Islands, Micronesia, Monaco, *Montenegro, Nauru, *Niue, *Norfolk Island, *Northern Cyprus (independence recognized only by Turkey), *Northern Mariana Islands, Palau, Panama, *Pitcairn Islands, *Puerto Rico, San Marino, *Tokelau, *Turks and Caicos Isands, Tuvalu, *U.S. Virgin Islands, Vatican City, Western Sahara (absorbed by Morocco). Certain other territories are not listed because they are integral parts of their mother countries or they are too sparsely populated to count.
Currency boards and currency board-like systems:
Currency boards (allow little discretion): *Bermuda, *Cayman Islands, *Falkland Islands, *Faroe Islands and *Gibraltar.
Currency board-like systems (allow considerable discretion): Bosnia (borderline orthodox), Brunei, Bulgaria, Djibouti, Estonia, *Hong Kong (borderline) and Lithuania.

2004 to reflect prices more accurately. Appropriate monetary policy—emphasizing the principles that have worked in other countries—can ensure that these factors remain one-time occurrences. But, as our review of the experiences of other countries has shown, this requires (1) a strong commitment to price stability and (2) a policy for the instruments to achieve price stability.

Egypt is following a flexible exchange rate route, so it should be able to adjust interest rates by the right amount to achieve price stability. In this regard, the changes the Egyptian government undertook in the second half of 2004 to make Egypt's foreign exchange market more efficient are most welcome. The decisions to rescind the foreign exchange surrender requirement[4] and to launch an inter-bank foreign exchange market have boosted foreign currency liquidity. Delays in obtaining foreign exchange for imports or profit remittances, which were a staple of the Egyptian business environment in recent years, have disappeared, as has the parallel market for foreign currency. Removing these distortions will do much to promote sustained growth. The Egyptian pound has appreciated by seven percent against the dollar and by 12 percent against the euro since late December. It is the first appreciation since the pound broke its ten-year peg to the dollar in 2000. Confidence in the Egyptian pound reflects increased confidence in Egypt's economic policymaking.

The Central Bank of Egypt, under the leadership of Governor Farouk El-Okdah, has introduced more coherence into monetary management. Interest rates on treasury bills and other savings instruments have been raised in an effort to counter inflation. And later this month, for the first time, the Monetary Policy Coordinating Council will meet to discuss a monetary policy framework, including goals and strategies to achieve those goals. Here it is important to state publicly a clear goal for price stability or low inflation whether stipulated as a formal numerical target or not. Here also is the time to be specific that the policy instruments—whether an interest rate or a monetary aggregate—be set in a way that will achieve this goal. There is no reason to postpone such actions while preparations to get better measures of inflation or better ways to forecast are underway. It may be sufficient for now to state what the instrument of policy will be,

[4] In 2003, prime ministerial decree no. 506 was issued, requiring that all companies convert 75 percent of their foreign currency revenues into Egyptian pounds at official bank rates.

and if it is the interest rate that it should change by enough to avoid reducing real interest rates when inflation rises.

To be sure, implementing a coherent monetary policy framework is particularly challenging in an emerging market country like Egypt. I reviewed some of these challenges in a paper I presented at a conference at the Bank of Mexico several years ago. It is often difficult to estimate the potential growth rate, the output gap, or the equilibrium interest rate. These challenges are greater where the informal sector is large and statistical coverage is limited. But none of the obstacles need be fatal to implementing a monetary policy framework oriented toward price stability, as I have discussed here.

Measures of inflation such as the consumer price index are never perfect. They are measures of where inflation has been rather than where it is going, and therefore need to be supplemented with data forecasts. Judiciously used, these indicators offer information about the general direction prices are more likely to take. Another way of dealing with lack of a reliable measure of inflation is to widen the target range for inflation, if an explicit numerical target for the rate of inflation is being used.

Fiscal dominance can also be a problem if the central bank is reluctant to raise interest rates when necessary because the government relies heavily on debt finance. There are two main ways to address the problem. One is to reduce government debt. Egypt's debt to GDP ratio is high. Restraint on spending combined with faster growth would reduce the ratio to a more comfortable level. The other way to address the problem is to make the central bank more independent. Changes to the banking law in Egypt in 2003 moved in that direction, but a more independent central bank would have a greater ability to make interest rate changes when appropriate.

To reduce government debt and enhance economic growth, Egypt must focus on reforming its banking system. Like many other countries, Egypt nationalized its banking system, and it has paid a heavy price. Credit was mainly channeled to state-owned enterprises, depriving viable private sector firms of credit. The government recently adopted a plan to reform the financial sector. Plans were also put together to reduce nonperforming loans at the state banks. The

commitment to privatize the Bank of Alexandria by the end of 2005, and the sale of state shares in some joint venture banks are tangible signs of the government's belief that the state's role in the financial sector must be reduced. Privatizing other state banks would also be beneficial. With greater efficiency in providing credit, a liberalized financial system will spur growth. It will also help monetary policy by providing market-based information that is critical for helping the central bank to make good decisions.

OTHER RECENT ECONOMIC REFORMS IN EGYPT

Moreover, the changes in monetary policy that I have focused on here serve as part of a broader set of reforms now being undertaken in Egypt. The United States supports President Mubarak and Prime Minister Nazif's joint vision of a more competitive, dynamic economy that meets the growing employment needs of the Egyptian population. The prime minister and his cabinet have already established their reform credentials by enacting a number of significant measures, including trade and tariff reform; foreign exchange market reform; and adjustments in administered prices. These market-oriented reforms have already paid dividends by boosting investor confidence in Egypt. Foreign direct investment in Egypt and portfolio inflows are on the rise. The Egyptian stock market has outperformed almost every other equity market in the world, rising more than 100 percent in the last nine months.

The reforms enacted to date are just the first stage of those necessary to bring about the growth Egypt needs. Fulfilling Prime Minister Nazif's vision will require sustained, strong, and at times difficult, actions by the cabinet and the People's Assembly. Plans to reduce personal and corporate income tax rates, reform the financial sector, and privatize many state-owned firms are welcome. Reform is also needed in the area of subsidies as they distort the economy and place a heavy burden on government finances. Carrying out reforms will further improve investor confidence in Egypt and improve the nation's ability to compete in the global economy.

CONCLUSION

Other countries have faced challenges similar to Egypt's and have addressed them. As I mentioned, price stability is being achieved in many countries around the world and has proved to be a robust framework capable of operating in a variety of environments. So, even though Egypt faces a variety of challenges in implementing monetary policy, it can employ solutions successfully applied elsewhere. And, success in monetary policy will contribute enormously to meeting Egypt's fundamental economic challenges of economic growth, job creation and raising living standards.

PART II: DISCUSSION

MONETARY POLICY IN EMERGING MARKET COUNTRIES WITH IMPLICATIONS FOR EGYPT

Participants in the discussion that followed John B. Taylor's presentation included Abdel Aziz Hegazy, Former Prime Minister of Egypt; Adel Bishai, Professor of Economics, American University in Cairo; Alaa Arafa, Chairman and CEO, Swiss Garments Co. and Member of ECES; Aliaa El Mahdy, Professor of Economics, Cairo University; Anissa Hassouna, Assistant General Manager of Research, Misr Iran Development Bank; Cyrus Sassanpour, Senior Resident Representative, International Monetary Fund; Doha Abdel Hamid, Senior Policy Advisor to the Minister, Ministry of Planning; Fouad Sultan, Chairman and Managing Director, Al Ahly for Development and Investment; Heba Handoussa, Director and Lead Author of the Egyptian Human Development Report and Professor of Economics; Mohamed Farid Khamis, Chairman, Oriental Weavers Group and ECES Board Member; Mohamed Ozalp, Vice Chairman, Bank Misr; Robert Feige, Senior Expert on Trade, Economy and Finance, European Commission Delegation; Samir Radwan, Managing Director, Economic Research Forum; Sherine El Shawarby, Senior Country Economist, the World Bank; Yasser Sobhi, Journalist, Al Ahram Newspaper. The following is a summary of the discussion.

Participant: Inflation targeting is certainly important and you have explained that quite well. However, I feel the problem in transition economies is employment targeting. I'd appreciate your reaction to this.

Speaker: What I've observed in experience and theory is that the most effective way to keep unemployment low and increase economic growth is not to let inflation rise and get out of control. The idea of price stability and low inflation, achieved gradually over time, is the best solution to keeping unemployment low. In the United States we've had much lower unemployment when inflation has been lower. Our periods of high unemployment have been

periods when inflation was high. Also, unemployment tends to rise during recessions. What we've found around the world is that low inflation has brought about fewer recessions and longer expansions. In the late 1960s and 70s when inflation was high in the United States, we had five recessions, some of the most serious in our history. Since the early 1980s we've had two mild recessions in the whole 20-year period and the longest expansions in American history. Look at the British economy too. What you observe is that since they've brought the inflation rate down, the chancellor has said they're experiencing the longest expansion in 200 years or more.

After the collapse of the Soviet Union, Eastern Europe had a terrible problem with inflation. Now that inflation is lower, they're doing much better. Who would've believed 10 or 15 years ago that Poland would be able to join the European Union? One of the big surprises to me is to observe that low inflation has brought about more stability. I don't really think anyone realized that until the mid-1990s when we began to observe long expansions in several countries and tried to find out why. This has been a very pleasant surprise and there are good reasons for it.

There is so much evidence now that the trade-off between inflation and unemployment or growth that people worried about in the past does not hold. To be sure, when you have higher inflation at the start it may take some time to bring it down. To do it gradually and to inform people about it makes sense. That's how many central banks have done things, and perhaps that's what the Central Bank of Egypt will do. This notion that there is a trade-off, I just don't see it anymore.

Participant: I have two remarks. After we floated the exchange rate in 2003, the dollar was 6.2 Egyptian pounds for quite some time. For some reason, many businessmen assumed that the rate was going to remain at that level. Now that the dollar is only 5.8 pounds, there are concerns that it could one day come down to 5.2 pounds. From your experience, what would be your prediction of the value of the pound in the future?

My second comment is that in the late 1990s our fiscal deficit was about one percent of GDP and the International Monetary Fund was pleased. However, the government expenditures and

fiscal deficit are now on the rise. Although our external debt is not a problem, our internal debt has become a serious problem. This problem has important bearing on the Central Bank and could lead to fiscal dominance. What is your comment on that?

Speaker: There is a question in Egypt about what is going to replace the old fixed exchange rate in monetary policy. Based on experience in other places, I've suggested price stability. That is, internal price stability with a low rate of inflation. When that goal is articulated and emphasized, it will in itself bring about more stability and provide for a more stable exchange rate. With respect to the particular level of the exchange rate, I really can't comment on that. All I can say is that it will be market-based and I believe there will be more effort to discover prices in forward markets, futures markets and that will create a more orderly market.

On government expenditures, controlling government spending in any country is essential for budget deficit reduction. We're currently doing that in the United States as part of President Bush's proposal to contain our deficit. I think it is a problem for central banks when debt gets too high as a share of GDP. That's why so often you hear central bankers talking about the importance of fiscal responsibility. It is important for Egypt to reduce its deficit.

Participant: I understand from your presentation that higher inflation requires increasing interest rates. My concern is that by increasing interest rates you also make it very difficult for new investment. Added to this, when interest rates on Treasury bills are 12 percent tax free, this is a disincentive to investment because it is much safer to earn 12 percent tax free than to set up a venture. With current inflation being about 12 percent, a significant rise in interest rate to contain inflation would lead to recession at a time when Egypt needs to create 600,000 jobs a year.

Speaker: If inflation has to be reduced I think it is important to do it gradually, which means that interest rates do not have to be too high. But I also think that you have to pay attention to the real interest rates here. If you get into a situation where inflation is rising while the nominal interest rate is not rising enough, the real interest rate falls which will make inflation worse. Also, if you

are able to get to a position of price stability and expectations of future price stability then interest rates will decrease, which will be very beneficial for growth. The aim is to have lower interest rates, but that will not occur if inflation is high.

Participant: There is no doubt that the floating of the pound and the unification of the exchange rates were beneficial to the Egyptian economy. But the complete liberalization of the capital account is another story. For a number of years Egypt has been suffering from a large budget deficit, large trade deficit, weak production base, low rate of savings and economic growth, and an investment climate that is not conducive to investment. I think the decision to completely liberalize the capital account was extremely detrimental to the economy in that it allowed substantial capital flight. Do you believe that this decision should have been preceded by balancing the government budget, stabilizing prices and liberalizing the current account?

Speaker: All of the things you mentioned are important goals for the future. Your question seems to be related to the sequence—should you have the current and fiscal accounts in line before you liberalize the capital account? I can see the reasons for that sequencing. However, I also know that frequently in politics and public policy, when you're trying to get things done you sometimes don't have the ability to sequence things so perfectly. It's hard enough to get a consensus when you're trying to bring about reform, but the actual timing is more difficult. In practice, you likely have a window of opportunity for one reform and then you have the window of opportunity for another.

My main point here is that it is important to eventually liberalize the capital account and the current account. In almost all cases that I know of the current account goes first. As for the capital account, liberalization is necessary if you want to attract FDI, as Egypt does. And here you want to have liberalization of FDI but not of short-term capital flows. But those are very difficult things to make happen.

Participant: I have a follow-up question. Would you agree that some control should be imposed on the capital account until we achieve full macroeconomic stability? That is not a call for closing the capital account, but for imposing some regulations to control capital flight. Would it also be advisable to impose some type of restrictions on indigenous capital flight but simultaneously allow foreign capital to get in and get out freely? In addition, should the Central Bank be in a position to intervene in the exchange market?

Speaker: I would be very wary of imposing restrictions on capital movements. The consequences of restrictions clearly depend on what the restrictions are, but in general I think it is dangerous to impose restrictions when you want to encourage capital to come in. If an investor is thinking about investing in a country, whether it's FDI or portfolio investment, and there is a concern that there will be some effort to stop capital flight then that's going to make them wary about investing in the first place. Every time you take a decision like that you have to worry about the consequences.

The last part of your question about the Central Bank's role in exchange stability and intervention is certainly something that has to be considered. I understand the value of that and I would never say that the Central Bank should never intervene in the exchange markets.

Participant: We agree about the value of price stability and low inflation rate. My concern is mainly about increasing interest rates to keep inflation low. Over the next 20 years Egypt's population will grow by about 2 million every year. We need investment to create jobs for these people, but FDI is very low and the level of savings is very low. If the interest rate is high, who is going to invest? I believe the United States is driving its economy and real estate market by keeping interest rates low. If interest rates increase, what is going to happen to growth, employment and job creation?

Speaker: I understand your thinking because getting inflation down will take some action and the action is higher interest rates to bring about low inflation. But this process can be done

gradually; it doesn't have to happen overnight and most important it is a short-run issue. Ultimately interest rates will be lower. The evidence supports my view. If you look at the average inflation rate in any country over the last ten years, you'll find low interest rates in countries with low inflation and high interest rates in countries with high inflation.

Participant: Are there other instruments or policies we can adopt to decrease inflation without increasing interest rates?

Speaker: You could use money growth as an instrument. If you want to lower inflation you could decrease money growth. The problem with that is that sometimes the relationship between money growth and inflation is not as precise as it used to be. That's why so many central banks have moved away from money growth toward interest rates. But in any case, inflation is due to money creation. It is caused by central banks raising the growth rate of money supply too much. There have been many other explanations as to what causes inflation, but ultimately it is money growth and monetary policy. The reason we use interest rates to talk about inflation so much is not that the money growth is not important, indeed it is essential to get it down, but because it is the practical way central banks can go about changing money growth.

Participant: Egypt is in a transition period. Despite subsidies, prices are still going up. Also, we haven't been successful in controlling the budget deficit. We have 5.5 million civil servants and we can't reduce such a large number at a time of high unemployment. We are creating money without working hard to improve the productivity of the 20 million workers in Egypt. What suggestions could you give to achieve the target of low inflation with higher productivity?

Speaker: I think the focus you're bringing to productivity is very important. I believe that Egypt is quite capable of growing steadily at much higher rates than it has been recently if productivity is addressed. There are some good beginnings here, for example, the tariff rate reductions. That will increase productivity in various ways because raw materials can come in more cheaply and

can be used in manufacturing; it's basically a cheaper way to get goods which raises productivity and therefore will ultimately raise wages. I think another productivity enhancing measure is privatization, because managers come in and focus on raising productivity, getting more capital and acquiring better machines. And finally the reduction of the tax rates is also important. The proposal to reduce tax rates also includes broadening the tax base. Reducing the rates and broadening the base are the key elements of tax reform which also will increase productivity and give more incentives for firms to expand and hire more workers. Those are the things that will raise productivity.

I think your point about the fiscal deficit is important because if you have a lower fiscal deficit real interest rates will be lower, which will encourage investment leading to more productivity because there will be more equipment for workers to work with. So I think it's very important when you talk about monetary policy, although it is really not about productivity. Monetary policy is about lower inflation which can have some benefits to productivity but the real policy changes are the other reforms that will ultimately cause the growth rates to increase. Monetary policy is just one component of that. It can't do everything. There seems to be hope that monetary policy can do too many things, but it really can't. It is designed to keep inflation low and that in itself is beneficial.

Participant: The culture in Egypt is geared more toward putting money into deposit accounts rather than investment. An important part of the story is the investment climate. Could you give us your impression of the current situation in Egypt in this regard?

Speaker: Yesterday, I visited the one-stop shop for business registration set up by the Investment Authority. I think what they're doing there is important because it's going to reduce the time and costs of creating new businesses. We have been following the number of days it takes to set up a small business in various countries and in Egypt it used to be well over 100 days to just start a firm. I think that setting up this very efficient operation is a great idea.

Participant: My concern is related to the new Monetary Policy Coordinating Council. I'd like your views on what areas you think the Central Bank should not be in negotiations with the government. Also, how much is the independence of the Central Bank compromised when you have such a council? My fear originates from the observation that the Coordinating Council will include three powerful members of the Egyptian Cabinet, who are likely to have quite an influence on committee decisions.

Speaker: I'd like to preface my remarks by saying that I don't know how this council will work in practice in Egypt. But, I feel it is useful to think of the concept of goals and instruments here. For a coordinating council to set a goal for low inflation and price stability on behalf of the government makes sense to me. I have seen that in other contexts, not necessarily with something called a coordinating council, but it basically gives more backing to the goal. That kind of broad government council has a role to play in emphasizing how important it is to have the goal of low inflation and price stability as a public policy goal.

With respect to the instrument, I think that's where you get into questions about independence. Decisions about interest rates and money growth, depending on the instrument, tend to be more technical and that is when issues about independence become worrisome. Maybe one way to look at it conceptually is as setting broad goals toward price stability, while the actual implementation of those goals is for the Central Bank or other committees.

Participant: Given your wealth of experience and Egypt's unique position, what advice would you give to the government on the issues of monetary policy and inflation targeting? What is the time framework for adopting this policy and what does it take to implement it? Finally, what is the relationship between exchange rate and interest rate policies?

Speaker: You need to have a gradual reduction of inflation. The business of being able to forecast inflation and having a big apparatus in monetary policy should not hold back establishing this framework. Sometimes people say you have to wait a long time for the technical

apparatus in order to have inflation targeting, but I think getting started with the goal of price stability and inflation targeting is pretty straightforward. Just go for it, let the techniques improve and get better measures of price stability as you go. I think the periodicity doesn't have to be every month but more or less adjusted on a much less frequent basis to see how things are going. I think I talked about fiscal dominance in my remarks. It's much better to get the fiscal deficit down.

Concerning the interest rate versus exchange rate, the hope is that there will be more stability in the exchange rates as policies develop even though they will be market-determined. But experience has shown that in monetary policy you always have to be thinking simultaneously about that other goal. If you ask central bankers around the world how they deal with the exchange rate when they're setting interest rates you get a lot of answers, but most frequently they worry that the exchange rate change will have implications for inflation itself and therefore implications for the interest rate. It's usually that channel that they focus on and I think that's a good way to do it.

Participant: When we look at the monetary situation in Egypt now, we observe a sharp rise in the CPI and WPI indices, which went up to 12 percent for the CPI and 16-17 percent for the WPI. Given that interest rates have not changed with the rise in inflation, we're talking about negative real interest rates. At the same time, we observe an increase in the rates of deposit creation accompanied by very low rates of credit creation. Negative real interest rate means cheaper borrowing for government, which motivates it to run large deficits. From your perspective, would it be advisable to raise the interest rate now to make it positive in real terms, and what would that do to the government debt and the business sector?

Speaker: The growth rate of deposits without growth in credit is I think to some extent related to the growth of the government debt. That's the crowding out that you worry about with respect to budget deficits because the Central Bank will obviously be taking on some of that and therefore there will be less credit. That's another reason to bring the deficit under control.

In terms of the specific recommendations as to where interest rates should be right now, I don't think it's appropriate for me to comment. I do, however, stress the importance of avoiding declines in real interest rates when inflation rises. If you have real interest rates falling while inflation is climbing, it's the kind of thing that can cause inflation to spiral upward. So the important thing is to have the Central Bank operating in a way that prevents that from happening.

Participant: I was wondering whether our measure of inflation should include asset prices, meaning the stock exchange and the real estate market. The reason is that stock prices in Egypt have been rising by more than 100 percent annually for the last two years.

Speaker: That's a good question. I think monetary policy works best when it focuses on the CPI and overall measures of inflation but it doesn't begin to add in the equity and real estate as formal factors. Of course monetary policy affects the whole economy and asset prices need to be taken into account. But this relates to debates that have occurred in the past about whether central banks should try to prevent asset price bubbles. I think the experience is that in the past it tended to burst bubbles; I'm not commenting on any particular asset prices right now, but in the past it proved to be counterproductive. Japan is the primary example. It had such a difficult time in the 1990s because it took special measures to deal with equity prices in the late 1980s. So if central banks try to focus on the traditional measures of inflation they're better off than trying to formally take the other asset prices into account.

Participant: I'd like to ask you about the flexible exchange rate approach adopted by emerging markets that are in transition. In your opinion, what are the most serious side effects that could lie ahead for Egypt in this respect?

Speaker: The move of those emerging markets that have gone to a flexible exchange rate has been very positive. As I mentioned in my lecture, in recent years many more emerging market countries have begun following flexible exchange rate regimes. I think that's one of the reasons

why there have been fewer crises because there are not those sharp movements that occur when there's a large devaluation or depreciation off of a fixed rate.

In terms of looking for things to be concerned about, orderliness of exchange markets and low volatility are important. I think for that purpose some of the things that can be done are to look for ways to set up futures markets and forward markets because that's part of the price discovery. If you sit on a trading floor in currency markets, especially the large ones in New York and London, you'll see they use these forward markets a lot to determine the price, which I think reduces volatility. As for emerging markets that choose to adopt the flexible exchange rate, like Egypt, the more they can encourage that kind of market activity the better, which will reduce volatility. So too much volatility could be the concern but I don't see it yet.

Participant: I would like to make a few comments and ask a question. To begin with, this Coordinating Council has attracted more attention than I thought it would. I may be wrong, but I hope that I'm right in saying that I don't see a sinister role in this council as many others do. There are still some important decisions to be made and key issues to be debated when you're moving toward a more transparent monetary policy. For example, long term inflation targeting—which would be appropriate for this economy because of the trade-offs that we talked about—the pace at which you want to reach that goal, and the instruments to achieve it. I think these are some of the key issues that, in this economy, should be decided collectively as they are probably not decisions that the Central Bank alone can make. So I can see a wider role on the part of the government and I'm also comforted by the fact that some extremely respected external economists are represented on the council.

On the exchange rate, I'd like to join Under Secretary Taylor and others who see and recognize the reform of the exchange rate as a key element of the reform process. It was mentioned at the beginning of this discussion that businessmen are a bit afraid about the exchange rate. When the businessmen are concerned and they don't know which way the exchange rate is moving, that means that the exchange rate must be working. The exchange rate

at 5.80 is a different animal than it was at 6.25 because the whole environment and framework has changed and the nature and size of external flows has changed. So I can see the merits of this exchange rate reform and its flexibility as a centerpiece of reform.

I'd like to discuss the issue of the current account versus capital account. We don't have to worry about restrictions on the capital account because the capital account is not free in Egypt. There is a current account convertibility and you may know Egypt formally notified the IMF in January that they will not impose any current account restrictions. As for capital account liberalization, which will occur eventually, there are many issues to be considered: macroeconomic stability, the health of the financial system, and so on. I want to emphasize the point made earlier that if you try to impose capital account restrictions then money will find its way out, especially in an economy like Egypt's.

In this transition to a more transparent and more indirect monetary framework the functioning of the banking system is critical for a number of reasons: to determine the transmission mechanism, how the impact of monetary policy signals is transmitted to the rest of the economy, the credit channel, and so on are all key issues to be settled. In a banking system where you have non-performing loans of 20 percent and declining real credit to the private sector, how would you set your sequencing? These issues can not be settled within the next two or three months, they are long-term issues. At the same time, the Central Bank and the government are determined to move toward an indirect and transparent monetary framework. Would you think that the slow progress on financial sector reform would prove to be a major hindrance to this effort?

Speaker: If the non-performing loan problem was addressed and there was a greater move toward privatization of banks, I think it would help with the formulation of monetary policy. You're right to say the transmission mechanism would be a little more predictable if the banks were operating that way. But I don't think it is something you would wait for to start implementing a monetary framework. There's no reason to delay. We still know, despite many

different types of organizational structures in a society, that inflation is basically caused by creating too much money, although it's much more complicated than that. If you just keep thinking about that fundamental I think you would not delay getting the fundamentals right. It is important to move ahead with financial sector reform. I really like the timelines and benchmarks the government is using. I think it could be something that would change the operation in important ways, but it's no reason to hold back on developing a monetary framework.

Participant: Could you tell us about your findings during your visit to Egypt? It is useful for businesspeople to know if you have observed any serious changes or real developments along the path of reform.

Speaker: In the economic sphere in general I have observed changes and I have been following them as closely as I can for awhile. My objective view is that anytime a country unilaterally reduces its tariffs by a significant amount and simplifies the customs law deserves praise because those changes are hard to do and they are big and beneficial to the economy. That has happened here in Egypt and I think it deserves a positive comment and congratulations. I mentioned the importance of what has happened in the exchange markets—the unification and how the parallel market basically doesn't exist anymore. I think that was a very important change and not easy to do. I think people realize the value of it already, so that deserves praise. I think the new tax reform proposal is important because marginal tax rates are to be lowered and the base broadened. That will increase the efficiency of the tax system and raise economic growth which is a goal of tax reformers all over the world. I think the effort to privatize banks and the financial sector deserves praise. In addition, there have been changes in subsidies which are difficult to do and efforts to deal with the budget deficit and encourage a better allocation of resources so that scarce government resources go to the poor people who need it not to others. So objectively speaking those changes are all very positive.

We've made it a point in the United States to try to support and work with countries that are doing the right thing on economic policy. Egypt is moving in the right direction so we want to be as supportive of that in our assistance and our comments. There's more to do in Egypt including education and judicial reform as well as further progress in the financial sector which I think is important in encouraging foreign investment. All of those things are important but let's also be positive about what has already been done as we emphasize the importance of going further.

Participant: One of the opportunities in the Egyptian banking sector is that many people are un-banked or under-banked. The flip side of that is that there is a large cash transaction economy. It is not unusual for a middle-class person to go buy a car with a sack full of money. So I wonder, without getting into specific details, to what extent could this be a hindrance to the authorities in trying to manage monetary policy? Is it a big issue or not?

Second, coming back to the discussion about asset prices, with the evolution of property prices in Europe and the United States and conceivably here in Egypt, I wonder whether this is something that may need to be revisited because there seems to be too much money chasing too few real estate assets.

Speaker: It is beneficial for people to do more banking because the funds get intermediated better and they go to increasing loans and encouraging more productivity. I don't think it’s a particular problem for monetary policy though. People in other countries have many different choices about the currency deposit ratio as we call it—how much currency is used compared to deposits—and over time, deposits are used more frequently than currency. The central banks can deal with that, it's just a matter of what the money multiplier will be.

Asset prices are a factor that need to be taken into account in estimating the strength of the economy and whether there's going to be an adjustment if prices move in the other direction. I think it's one of many things that monetary policymakers have to be concerned with. Not one that

I would hold out there as a key one at this point, but it is one of many important factors. You also have high commodity prices, high oil prices that are also factors in monetary policy right now.

Participant: Since the early 1980s, I have been hearing that Egypt is in a transition period. Given that we are living in a globalized world, we expect reforms to be a continuous process in a developing country like Egypt. But how long does a transition period last? Regarding inflation and growth, from what I understood from you, there is no trade-off. This may be true in the long run, but in the short run it seems to me there is a trade-off. In your opinion, what should we look at first: to increase the growth rate and then worry about inflation, or reduce inflation then worry about the growth rate? We have a severe unemployment problem now, and the question is how can we tackle this in the short run. Finally, you said that changing the instruments by the right amount should be our target, but defining the right amount is the problem. How can we determine the right amount of change in instruments like interest rates for instance? Should we run some econometric work and rely on historical data despite its limitations in terms of frequency, availability and quality in Egypt? Or should we follow the approach of trial and error or look at the experiences of other countries?

Speaker: Your point about transition periods is important. You don't want transitions to last forever. But it also depends on what policy you're talking about. In the area of trade the removal of barriers is a long transition so that people can adjust. I know in the case of the global trade rounds in the past that there was this very gradual reduction many years in advance before the Multi-Fibre Agreement was actually removed, but now it's gone. So that was a transition that was long but it's finished. I think we tend to think that transitions have to be longer than they need to be. My sense is that we've observed the advantages of shorter rather than longer transitions in monetary policy.

On your second question regarding the existence of a short-run trade-off, there is no question about it. But that depends on the credibility of monetary policy, on the expectations, how long

inflation has been rising, and how high inflation is. If I may comment on Egypt, I think the recent increase in inflation is from a previous period when inflation was kept lower than it would have been. I think a lot of the recent inflation comes from depreciation. In such cases, the evidence says it doesn't take as much effort to get it back down again because it hasn't been built into the expectations or the momentum. Every country is of course different, but if you look carefully at Turkey and Brazil in the last two or three years, both underwent big depreciations and big movements of the inflation rate, but they brought it back down again in a shorter period than many people had expected. I think that's one answer to your question about the short-run trade-off.

How much you should change interest rates is one of the hardest questions in monetary policy. The rule that I worked on was an effort to quantify that and that is just one quantification, but there are many others. Models and simulations are part of the answer. That's what many central banks do now; they run projections of what will happen with alternative levels of the interest rate and make a decision about what it should be. Ultimately, it comes down to the principles that I mentioned in my remarks.

Moderator: Thank you Dr. Taylor. We have been very privileged to have you with us today to discuss monetary policy as an important element of the economic reform process. Also, I would like to thank the participants for their insightful comments and questions.

LIST OF ATTENDEES

Abdel Aziz Hegazy
Former Prime Minister of Egypt
Abdel Rehim Maksoud
Central Bank of Egypt
Adel Bishai
Economics Department, American University in Cairo
Ahmed Baghat
Emerging Markets Holding
Ahmed Gheith
Middle East News Agency
Ahmed Kamaly
Economics Department, American University in Cairo
Ahmed Noshy
Central Bank of Egypt
Alaa Abou Alam
Arab Contractors
Alaa Arafa
Swiss Garments Co. (SGC) and ECES
Aliaa El Mahdy
Faculty of Economics, Cairo University
Amal El Tobgy
A.I.T. Consulting
Amina Ghanem
Ministry of Finance
Amna Bakr
Reuters
Anissa Essam El-Din Hassouna
Misr Iran Development Bank
Ann Marie Roubachewsky
US Embassy – USFCS
Ashraf Mahmoud
Al Ahly for Development and Investment
Cyrus Sassanpour
International Monetary Fund
Daniel Peter
US Embassy
Daniel Ross
US Embassy
Dina Khayatt
Phoenix Asset Management Egypt
Doha Abdel Hamid
Ministry of Planning
Fouad Sultan
Al Ahly for Development and Investment
Gamal Shahin
Middle East Newspaper
Hala El Said
The Egyptian Banking Institute
Hala Fayek
MIBank
Hania Moheeb
CNBC
Heba Handoussa
Egypt Human Development Report
Hoda Youssef
IRD French Research Institute
Hussein El Sherbiny
Hussein Choucri Securities and Investment
Ingy Tawakol
CIPE
Ismail Hassan
Misr Iran Development Bank
John Desrocher
US Embassy
Joseph S. Ryan Jr.
USAID Cairo Mission

Kamal Nasr
Ministry of Foreign Affairs
Kenichi Kashiwagi
Embassy of Japan
Khaled El Naggar
Dutch Bank
Khalil Nougaim
Cairo Capital Group
Magdy Khalil
USAID
Magued Aly
Al Masry Al Youm Newspaper
Mahmoud Abdel Latif
Bank of Alexandria
Mahmoud Mohamed
CAPMAS
Mahmoud Salem
Akbar El Youm Newspaper
Marc Gellerson
USAID Cairo Mission
Maysa Maher
Nile TV
Mohamed El Sheikh
Al Alam El Youm Newspaper
Mohamed Khamis
Oriental Weavers Group
Mohamed Saleh
Ministry of Investment
Mohamed Negm
October Magazine
Mohamed Nosseir
Global Marketing Consultancy
Mohamed Ozalp
Banque Misr
Mounir Abdel Nour
Vitrac and ECES
Nehal Rezk
US Embassy
Nevine Wahish
Al Ahram Weekly Newspaper
Raed H. Yehia
Misr America Carpet Mills and ECES
Rafia Madkour
Commercial International Bank
Reham Mohsen
US Embassy
Robert Feige
European Commission Delegation
Salah Idris
League of Arab States
Salwa El Antary
National Bank of Egypt
Samar El Molla
Arab Bank
Samia El Zanfaly
Arab International Bank
Samia Torky
Central Bank of Egypt
Samir Radwan
Economic Research Forum
Sherine El Shawarby
The World Bank
Slim Tlatli
Federation of Egyptian Industries
Souraya Abo El Saoud
Ministry of Foreign Affairs
Taher Helmy
Helmy, Hamza & Partners and ECES
Yasser Sobhi
Al Ahram Newspaper

Distinguished Lecture Series

Egypt has recently shifted to a monetary policy framework that focuses on price stability. In this edition of the distinguished lecture series, John B. Taylor, a world-renowned scholar in monetary economics, explains how emerging markets made the transition from using the exchange rate as a nominal anchor to inflation targeting. To this end, he emphasizes the importance of adopting a clear monetary rule to guide expectations, arguing that the alleged trade-off between price stability and unemployment is not supported by recent evidence.

With respect to Egypt, Dr. Taylor particularly applauds the recent developments in monetary policy and the current reform efforts to put Egypt on a path of sustainable growth with lower inflation. At the same time, he points out the need for more reform efforts, especially in areas of financial sector reform, deficit reduction, and privatization of state-owned enterprises.

This publication is the twenty-third in the Distinguished Lecture Series published by the Egyptian Center for Economic Studies